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BEFORE THE ARIZONA CORPORATION COMMISSION

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COMMISSIONERS

KRISTIN K. MAYES, Chairman

GARY PIERCE

PAUL NEWMAN

SANDRA D. KENNEDY

BOB STUMP

2010 NOV 10 P 3: 53

ARIZONA CORPORATION COMMISSION
DOCKET CONTROL

IN THE MATTER OF THE APPLICATION OF
CHAPARRAL CITY WATER COMPANY, INC.
FOR A WAIVER UNDER A.A.C. R14-2-806 OR,
IN THE LATERNATI VE, NOTICE OF INTENT
TO REORGANIZE UNDER A.A.C. R14-2-803.

DOCKET NO. W-02113A-10-0309

**STAFF'S NOTICE OF FILING
DIRECT TESTIMONY**

The Utilities Division ("Staff") of the Arizona Corporation Commission ("Commission")
hereby files the Direct Testimony of Staff Witness Darron W. Carlson in the above-referenced
matter.

RESPECTFULLY SUBMITTED this 10th day of November, 2010.

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10th day of November, 2010 with:

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Phoenix, Arizona 85007

Arizona Corporation Commission

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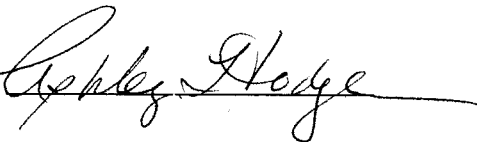
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BEFORE THE ARIZONA CORPORATION COMMISSION

KRISTIN K. MAYES

Chairman

GARY PIERCE

Commissioner

PAUL NEWMAN

Commissioner

SANDRA D. KENNEDY

Commissioner

BOB STUMP

Commissioner

IN THE MATTER OF THE APPLICATION OF)
CHAPARRAL CITY WATER COMPANY, INC.)
FOR A WAIVER UNDER A.A.C. R14-2-806 OR,)
IN THE ALTERNATIVE, NOTICE OF INTENT)
TO REORGANIZE UNDER A.A.C. R14-2-803)
_____)

DOCKET NO. W-02113A-10-0309

DIRECT

TESTIMONY

OF

DARRON W. CARLSON

PUBLIC UTILITIES ANALYST MANAGER

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

NOVEMBER 10, 2010

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EXECUTIVE SUMMARY
CHAPARRAL CITY WATER COMPANY, INC.
DOCKET NO. W-02113A-10-0309

Chaparral City Water Company, Inc. ("CCWC" or "Company") is an Arizona public service corporation and a Class "A" water utility. It provides water utility services in portions of eastern Maricopa County, including the town of Fountain Hills. At the present time, CCWC provides water services to approximately 13,000 customers, of which the vast majority are residential customers.

CCWC filed an application with the Arizona Corporation Commission ("Commission") on July 23, 2010, for a waiver of the requirements of the public utilities holding companies and affiliated interests rules (A.A.C. R14-2-801, *et seq.*) ("Rules") that may be allowed under A.A.C. R14-2-806. In the alternative, if the Commission denies the waiver, the Company requests that the Commission consider this same application a notice of intent to reorganize ("Notice") under A.A.C. R14-2-803.

The reorganization involves the purchase of CCWC from its current parent, American States Water Company ("American States"), a California corporation, by EPCOR Water (USA), Inc. ("EPCOR USA"), a Delaware corporation. American States will sell all of the issued and outstanding shares of CCWC's common stock to EPCOR USA.

Staff concludes that, after the subject reorganization, CCWC will experience no short-term changes, benefits, or detriments. Staff also believes that CCWC will experience no measurable long-term changes, benefits, or detriments.

Recommendations:

Staff recommends denial of the request for a waiver of the Rules.

Staff recommends approval of the requested reorganization, with the following conditions:

- That the Company and its affiliates fully cooperate with Staff in any future inquiries or requests for information and/or documents regarding any transactions that Staff determines might have some effect, direct or indirect, on the Company's operational or financial health.
- That the Company refrain from seeking an acquisition adjustment due to this transaction in any future rate case.
- That the Company shall maintain its quality of service, including, but not limited to, that the number of service complaints should not increase, that the response time to service complaints should not increase, and that service interruptions should not increase as a result of the reorganization.

INTRODUCTION

Q. Please state your name, occupation, and business address.

A. My name is Darron W. Carlson. I am a Public Utilities Analyst Manager employed by the Arizona Corporation Commission ("ACC" or "Commission") in the Utilities Division ("Staff"). My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

Q. Briefly describe your responsibilities as a Public Utilities Analyst Manager.

A. In my capacity as a Public Utilities Analyst Manager, I supervise one of two groups of Public Utilities Analysts in the Financial and Regulatory Analysis section of the Utilities Division, who examine, verify and analyze utilities' statistical, financial, and other information. These analysts write reports and/or testimonies based on their analyses that provide Staff recommendations to the Commission on rates, mergers, acquisitions, financings, sales of assets, and other matters. I provide support and guidance along with reviewing and editing the work products. I perform analysis as needed on special projects. I can be called upon to provide expert testimony at formal hearings and train others on techniques of presenting testimony. Additionally, I provide support and advice regarding accounting, tax, and other financial matters to Staff attorneys during formal hearings involving direct, rebuttal, surrebuttal, rejoinder, cross, and redirect testimonies.

Q. Please describe your educational background and professional experience.

A. I hold Bachelor of Arts degrees in both Accounting and Business Management from Northeastern Illinois University in Chicago, Illinois. I have participated in a number of seminars and workshops related to utility rate-making, cost of capital, and similar issues. These have been sponsored by organizations such as the National Association of Regulatory Utility Commissioners ("NARUC"), Duke University, Florida State University, Michigan State University, New Mexico State University, and various other

1 organizations. I have led or actively participated in more than 135 cases before this
2 Commission over the last nineteen years. Since my promotion to management, I have
3 supervised analysts involved in more than 200 additional cases before this Commission.
4

5 **Q. What is the purpose of your testimony in this case?**

6 A. The purpose of my testimony in this proceeding is to present Staff's position and
7 recommendations regarding the application of Chaparral City Water Company, Inc.
8 ("CCWC" or "Company") for a waiver of the requirements of the public utilities holding
9 companies and affiliated interests rules (A.A.C. R14-2-801, *et seq.*) ("Rules") that may be
10 allowed under A.A.C. R14-2-806, which was filed with the Commission on July 23, 2010.
11 In the alternative, if the Commission denies the waiver, the Company requests that the
12 Commission consider this same application a notice of intent to reorganize ("Notice")
13 under A.A.C. R14-2-803.
14

15 **Q. Have you reviewed the application submitted by the Company in this case?**

16 A. Yes. I reviewed the Company's application and note that there was no Direct Testimony
17 submitted with the application. The Company is requesting the Commission's approval
18 without a hearing pursuant to A.A.C. R14-2-803(C).
19

20 **GENERAL INFORMATION**

21 **Q. Please briefly describe CCWC.**

22 A. CCWC is an Arizona public service corporation and a Class "A" water utility. It provides
23 water utility services in portions of eastern Maricopa County, including the town of
24 Fountain Hills. At the present time, CCWC provides water services to approximately
25 13,000 customers, of which the vast majority are residential customers.
26

1 **Q. Please describe the reorganization that is the subject of this filing.**

2 A. The reorganization involves the purchase of CCWC from its current parent, American
3 States Water Company ("American States"), a California corporation, by EPCOR Water
4 (USA), Inc. ("EPCOR USA"), a Delaware corporation. American States will sell all of
5 the issued and outstanding shares of CCWC's common stock to EPCOR USA.

6
7 According to the public announcement of the purchase, the purchase price for CCWC is
8 approximately U.S. \$35,000,000. The terms include a cash payment of U.S. \$29,000,000
9 and the assumption of U.S. \$6,000,000 in long-term debt. Staff found nothing in the
10 confidential stock purchase agreement between American States and EPCOR USA to
11 contradict this information.

12
13 Staff has determined that the purchase price is in excess of the net book value of the
14 Company's assets and liabilities. CCWC has indicated that it will not seek an acquisition
15 adjustment in any future rate case.

16
17 **Q. Are there any other entities that would or could be directly, or indirectly, involved**
18 **with CCWC after the merger?**

19 A. Yes, there are. EPCOR USA is an indirect wholly-owned subsidiary of EPCOR Utilities,
20 Inc. ("EPCOR"). EPCOR is a municipally-owned Canadian corporation and holding
21 company that builds, owns, and operates water and wastewater treatment facilities and
22 infrastructure and electrical transmission and distribution networks, in Canada. EPCOR is
23 governed by an independent Board of Directors, and its sole shareholder is the City of
24 Edmonton ("City"), Alberta, Canada.

25

1 EPCOR is the parent company of a number of subsidiary companies. Its primary
2 operating utility subsidiaries are EPCOR Water Services, Inc. ("EPCOR Water"), EPCOR
3 Distribution & Transmission, Inc. ("EPCOR Distribution"), and EPCOR Energy Alberta,
4 Inc. ("EPCOR Energy"). The Company's application includes further descriptions of
5 these EPCOR subsidiaries.
6

7 **WAIVER OF THE RULES**

8 **Q. Please describe CCWC's request for a waiver of the Rules.**

9 A. CCWC is requesting a complete waiver of the Rules based on its contention that the
10 reorganization will have no effect or impact on CCWC.
11

12 **Q. Under what criterion can the Rules be waived?**

13 A. A.A.C. R14-2-806 (A) reads, "The Commission may waive compliance with any of the
14 provisions of this Article upon a finding that such waiver is in the public interest."
15

16 **Q. Does Staff interpret the "public interest" to mean no harm or a benefit?**

17 A. Staff has determined that a benefit is necessary in order for a waiver to be in the public
18 interest.
19

20 **Q. Did CCWC describe or demonstrate that the waiver request of the subject**
21 **reorganization is in the public interest?**

22 A. CCWC stated that the reorganization is in the public interest; however, it also indicated
23 that the reorganization would have no effect on CCWC. CCWC did not otherwise
24 demonstrate any benefit that would result from the transaction.
25

1 **Q. Did Staff attempt to find any measurable benefit as a result of the reorganization?**

2 A. Staff reviewed the application, various annual reports, the Company's responses to Staff's
3 data requests, and the Company's responses to the Residential Utility Consumer Office
4 ("RUCO") data requests and could not identify any measurable benefit resulting from the
5 reorganization.

6 **Q. What is Staff's recommendation regarding CCWC's request for a waiver?**

7 A. Staff recommends denial of the Company's request for a waiver of the Rules.
8

9 **NOTICE OF INTENT TO REORGANIZE**

10 **Q. Did CCWC file a notice of intent to reorganize?**

11 A. Yes, CCWC's original application for a waiver of the Rules also contained a notice of
12 intent to reorganize, in case the Commission determined that a waiver was not appropriate.
13

14 **Q. What has Staff concluded from its review of the Notice and the additional**
15 **information supplied by CCWC pursuant to Staff and RUCO data requests?**

16 A. Staff has some concerns regarding the willingness of CCWC to allow access to its
17 affiliates books and records as contemplated by the rules. While CCWC provided
18 responses to Staff data requests, CCWC seemed to indicate that access and providing
19 information related to two specific parent transactions were "irrelevant".
20

21 **Q. If Staff received sufficient responses to all of its data requests, why is Staff**
22 **concerned?**

23 A. The Rules cover the Commission's review of transactions between public utilities and
24 affiliates. In general, A.A.C R14-2-804 states that, in order to transact business with an
25 affiliate, the utility must agree to provide the Commission with access to the books and
26 records of the affiliate to investigate transactions between the two. The utility is also

1 obligated to maintain necessary accounting records regarding transactions with each
2 affiliate. The Rules were created so that the Commission could be made aware of
3 transactions and other occurrences at the holding company level that may affect the
4 regulated utility's operations or financial well-being – even if indirectly. In the past, when
5 dealing with utilities with corporate parents, Staff has sometimes experienced difficulties
6 obtaining information at the parent level that Staff believed was necessary for a complete
7 analysis. Staff notes this concern now in hopes of avoiding any such delays or lack of
8 cooperation in this and any future proceedings the Commission may have with the
9 Company.

10
11 **Q. What is Staff's recommendation?**

12 A. Staff recommends that the Commission Order the Company and its affiliates to fully
13 cooperate with Staff in any future inquiries or requests for information and/or documents
14 regarding any transactions that Staff determines might have some effect, direct or indirect,
15 on the Company's operational or financial health.

16
17 **FINANCIAL ASPECTS**

18 **Q. What does the Commission consider when evaluating a Notice?**

19 A. Under A.A.C. R14-2-803 (C), "[T]he Commission may reject the proposal, if it
20 determines that it would impair the financial status of the public utility, otherwise prevent
21 it from attracting capital at fair and reasonable terms, or impair the ability of the public
22 utility to provide safe, reasonable, and adequate service."

23
24 **Q. Did Staff perform a financial comparison of American States versus EPCOR USA?**

25 A. Staff found that EPCOR USA, established in 2009, had very little useful financial
26 information available. Alternatively, Staff reviewed financial information on EPCOR and

1 compared that information to American States. That comparison indicates that EPCOR is
2 a larger entity than American States based on sales volume, plant values, and number of
3 customers served. Additionally, Staff found that EPCOR has a better bond rating average
4 than American States.

5
6 **Q. Does Staff believe that this merger might improve CCWC's financial status?**

7 A. No, the Company has already indicated that there will be no change to CCWC after the
8 merger. Realistically, CCWC's financial status can only be measured in a rate case where
9 it indicates/estimates its cost of debt, cost of equity, and capital structure that leads to the
10 cost of capital to be considered at that time. There is no indication in the subject
11 application that any of these items may be improved or changed from the previously-
12 approved cost of capital that supports the Company's current rates.

13
14 **Q. Does Staff believe the subject merger could impair the Company's financial status?**

15 A. No, Staff did not find any evidence that the Company's financial status would be harmed
16 or impaired.

17
18 **OPERATIONAL ASPECTS**

19 **Q. Does Staff believe that this merger might improve or impair CCWC's operational**
20 **status?**

21 A. The Company's application indicates there will be no change to CCWC subsequent to the
22 subject merger. Staff does note that there will be one change to the CCWC staff. The
23 District Manager position will be filled by a replacement from EPCOR. That position is
24 currently filled (on an interim basis) by an employee of Golden State Water Company (an
25 affiliate of American States). All other CCWC positions will remain the same after the
26 subject merger.

1 **Q. Has Staff reviewed the customer service policies and how they might change?**

2 A. The Company has indicated that customer service, during working hours, will remain the
3 same. The local Fountain Hills office will handle all customer service calls. The after-
4 hours service calls are currently handled by American States' California Call Center.
5 After the subject merger, the after-hours service calls will be handled by EPCOR Water
6 Services Dispatch Centre, located in Edmonton, Alberta, Canada. The Canadian Centre is
7 staffed 24 hours per day, seven days a week to handle any water emergencies.
8

9 **Q. Does Staff see any problems in customer service due to the distance between**
10 **Fountain Hills and Edmonton?**

11 A. Staff does not believe that distance should be a problem. All calls would be taken in the
12 same way they are now in California. Any need for immediate action would be taken by
13 "on-call" personnel in the local Fountain Hills office.
14

15 **Q. What does Staff recommend?**

16 A. The Company shall maintain its quality of service, including, but not limited to, that the
17 number of service complaints should not increase, that the response time to service
18 complaints should not increase, and that service interruptions should not increase as a
19 result of the reorganization.
20

21 **CONCLUSION**

22 **Q. What is Staff's conclusion?**

23 A. Staff concludes that, after the subject reorganization, no short-term changes, benefits, or
24 detriments will accrue to CCWC. Staff also believes that no measurable long-term
25 changes, benefits, or detriments will accrue to CCWC.
26

1 **RECOMMENDATIONS**

2 **Q. What are Staff's recommendations?**

3 A. Staff recommends denial of the request for a waiver of the Rules.

4
5 Staff recommends approval of the requested reorganization, with the following conditions:

6
7 That the Commission order the Company and its affiliates to fully cooperate with Staff in
8 any future inquiries or requests for information and/or documents regarding any
9 transactions that Staff determines might have some effect, direct or indirect, on the
10 Company's operational or financial health.

11
12 That the Commission order the Company to refrain from seeking an acquisition
13 adjustment due to this transaction in any future rate case.

14
15 That the Commission order the Company to maintain its quality of service, including, but
16 not limited to, that the number of service complaints should not increase, that the response
17 time to service complaints should not increase, and that service interruptions should not
18 increase as a result of the reorganization.

19
20 **Q. Does this conclude your Direct Testimony?**

21 A. Yes, it does.